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November 6, 2008

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02889

RE: *National Grid Request for Change of Gas Distribution Rates,* Docket No. 3943

Dear Ms. Massaro:

Enclosed please find an original and seven (7) copes of the Initial Brief of Rhode Island Hospital in the above-captioned proceeding. We also have submitted this filing in electronic format.

Please contact me should you have any questions concerning this matter.

Very truly yours,

Andrew O. Kaplan

cc: Service List

Enc.

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Certificate of Service

I hereby certify that a copy of the cover letter and/or any materials accompanying this certificate were electronically submitted and mailed to the individuals listed below.

Andrew O. Kaplan, Esq.

Date: November 6, 2008

National Grid (NGrid) – Request for Change in Gas Distribution Rates
Docket No. 3943 - Service List as of 9/15/08

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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
BEFORE THE PUBLIC UTILITIES COMMISSION

NATIONAL GRID APPLICATION FOR AN INCREASE IN GAS DISTRIBUTION RATES	))))	Docket No. 3943

INITIAL BRIEF OF RHODE ISLAND HOSPITAL

I. SUMMARY

Rhode Island Hospital ("RIH" or the "Hospital"), a firm and non-firm gas customer of National Grid (the "Company"), has for the first time in its history participated as an intervenor in a rate proceeding before Rhode Island Public Utilities Commission (the "Commission"). This unprecedented intervention was necessitated by the need to alleviate the dramatic and unpredictable changes that Rhode Island Hospital has experienced with its monthly interruptible gas service bills over the last two years. Unable to reliably budget its energy costs due to widely fluctuating interruptible gas prices, the Hospital has devoted significant resources and has presented substantial support to develop an equitable and reasonable pricing structure.

Conversely, the Company fails to address the concerns of the Commission to impose just and reasonable rates for institutional and non-firm dual-fuel customers, especially in light of the Rhode Island economy, which is experiencing the highest unemployment rate in the United States, according to the US Bureau of Labor Statistics as of September 30, 2008. The Commission's establishment of just and reasonable rates for the large institutional and non-profit non-firm customers is essential to help stabilize the economic situation, especially for the service industry and manufacturing sectors that use large quantities of gas and oil and are operating in one of the worst business environment since the Great Depression.

The Company's proposed resolution to the instability in gas transportation prices is to cap non-firm rates at more than 150 percent *above* those rates paid by National Grid's firm customers, even though the Company admits that only minimal costs are incurred to serve non-firm customers and the Company can interrupt service to non-firm ratepayers at any time. Significantly, as detailed herein, National Grid's proposal to charge non-firm ratepayers at levels in excess of its large firm service customers is unsupported by the record evidence. The Company's proposal fails to acknowledge the significant economic benefits that the Company derives from its sale of excess distribution capacity to non-firm service customers at revenues in excess of $5 million for the most recent annual period. Finally, National Grid's proposal, if adopted, will result in inequitable rates for the service provided.

In response, the Hospital has proposed a rate plan for non-firm customers that allows the Company to recover the incremental costs associated with serving interruptible customers while providing a significant contribution to the cost of the gas distribution system otherwise charged to firm customers. Specifically, the Hospital proposes to establish a non-firm rate structure that would (1) make a significant contribution to the cost of the distribution system, (2) generate revenues from non-firm ratepayers consistent with historic levels and (3) establish a just and reasonable rate for National Grid's non-firm customers.

II. PROCEDURAL BACKGROUND

On April 1, 2008, the Company filed its request for Commission approval of a rate increase of approximately $20 million or 4.6 percent. On May 27, 2008, the Hospital submitted a timely and unopposed motion to intervene in this proceeding. Subsequently, the Hospital submitted discovery requests pertaining to the Company's proposed rate design for its non-firm customers.

Despite the Hospital's good faith efforts to resolve issues with respect to non-firm transportation rates, no agreement on settlement terms could be reached. Thus, to ensure that the record evidence included a reasonable non-firm rate structure for the Commission's consideration, the Hospital presented its witness, James DeMetro, principal of Energy and Management Consulting. During the hearings, Mr. DeMetro proposed to calculate non-firm transportation rates using a mechanism that would yield just and reasonable rates for interruptible customers.

This Initial Brief is submitted in accordance with the Commission's timeline for parties to submit briefs. The Hospital reserves its right to submit a Reply Brief, as allowed by the Commission.

III. INFORMATION ABOUT RHODE ISLAND HOSPITAL

The Hospital is a 719 bed, 2.5 million square foot acute care teaching and research facility with approximately 5,800 employees. The hospital discharges over 35,000 patients annually, treating over 143,000 emergent care patients and admitting many patients without regard to their ability to pay for the care received. Each year, the Hospital incurs over $40 million in health care costs in order to provide patient services to those who are un-insured or under-insured. Indeed, the Hospital provides over $72 million in charity care and other community benefits.[1]

The Hospital is both a firm and non-firm customer of National Grid. Its annual laundry firm gas supply totals approximately 1,100 dekatherms with a fixed transportation cost of $.65 per dekatherm. The non-firm gas supply requirement for steam and power generation is approximately 1,100,000 dekatherms annually. Based on actual transportation cost escalations in

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[1] This amount includes the net cost of charity care, medical education, research, subsidized health services and community health improvement services and community benefit operations. *See* Lifespan Annual Report, 2007.

2008, the distribution charges for RIH for non-firm service totaled approximately $1,400,000 as compared to approximately $125,000 had the transportation rate been set at the minimum levels set forth in the current rate tariff.

IV. LEGAL STANDARD OF REVIEW

Pursuant to R.I. Gen. Laws.§. 39-1-1, the Commission has been charged with the regulation of public utilities to promote the availability of adequate, efficient and economical energy and to ensure energy services are provided at just and reasonable rates and charges without unjust discrimination, undue preferences or advantages or unfair or destructive practices. The Hospital asserts that the Commission's review of the rate proposals to provide interruptible service to non-firm customers must be undertaken in light of these specific policy mandates.

Similarly, under R.I. Gen. Laws § 39-2-1, utilities are mandated to collect only such rates and charges that are just and reasonable for any service rendered. The statute does not differentiate between classes of customer or the type of service rendered. Instead, the plain reading of law states that <u>any</u> service must be rendered at just and reasonable rates. Although R.I. Gen. Laws § 39-2-5 provides that in certain limited exceptions, a utility may employ a special rate or special customer class, such exceptions must be just and reasonable or required in the public interest <u>and</u> not unjustly discriminatory.

V. ARGUMENTS

A. *National Grid's Non-Firm Gas Transportation Customers Receive a Lower Level of Service Than its Firm Customers.*

Unlike firm customers who are guaranteed by National Grid that there will be sufficient capacity to meet their gas transportation needs under any system conditions, the Company's interruptible customers receive service *only* if there is excess capacity on the system. Specifically, the Company's non-firm transportation service tariff states that the Company can "curtail or discontinue service when, in the sole opinion of the Company, such curtailment or interruption is necessary in order for it to continue to supply the gas requirements of firm customers . . . ."[2] By definition therefore, non-firm gas transportation service is curtailed any time that National Grid determines, in its sole discretion, that the Company is incapable of providing reliable gas service to its firm ratepayers. Upon making such a determination, National Grid notifies its non-firm customers, at least one-hour but no more than three days' before gas service will be discontinued.[3] The Company's right to curtail gas service of one customer class enables the Company to optimize the use of available distribution capacity when firm customers are not fully utilizing their entitlements, or when problems exist on its distribution system or with concentrations of heating load.[4] Clearly, the value of gas service is greatest at the time when demand is the highest. The fact that a non-firm ratepayer's gas service can be interrupted at those key times of peak demand clearly demonstrates that non-firm ratepayers receive a lesser service than firm ratepayers and that the cost of that service should be significantly lower.

For that reason, the Hospital respectfully requests that the Commission find that National Grid provides a higher and more valuable level of service to its firm ratepayers than to its non-firm ratepayers and, accordingly, find that rates charged by National Grid to its non-firm ratepayers should be significantly lower to reflect the limited nature of the service received.

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2 *See* Non-Firm Sales Service Rate 60.

3 *Id.*

4 Transcript dated October 8, 2008 at 67.

B. ***Because of their Limited Use of the Distribution System, National Grid Incurs Lower Costs To Serve Non-Firm Gas Transportation Service Customers.***

As established above, National Grid does not provide its non-firm ratepayers with a service comparable to firm ratepayers. Moreover, because National Grid is under no mandate to serve non-firm ratepayers, the Company has invested no money to increase the capacity of the distribution system to serve those customers.[5] Instead, as demonstrated by the record evidence, the Company's distribution system has been designed and built only to serve firm customers on a year-round basis.[6] Although the Company has not undertaken a comprehensive engineering load and design study to quantify the total investment that would be needed before it could upgrade its existing non-firm customers to firm service, a preliminary review of the expected infrastructure needs of several non-firm customers indicates that the costs would total "at least $9 to $10 million."[7] National Grid avoids these costs otherwise charged to firm ratepayers provided it maintains non-firm service.

Despite the limited and less valuable nature of service provided to non-firm ratepayers and the undisputed fact that no costs have been incurred by the Company to add infrastructure to serve non-firm ratepayers, the Company's non-firm customers have been subject to rates that are significantly higher than those charged to the Company's comparably-sized firm customers. For example, in September 2008, the Hospital's non-firm transportation rate was $2.83 per dekatherm.[8] Even at that price, the Hospital was subject to interruption of its gas service at any time and for any reason, with little prior notice from the Company. In contrast, National Grid's extra large high load Commercial and Industrial firm gas service customers (for which the

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[5] RR-DIV-6 and RR-DIV-7;

[6] Transcripts dated October 8, 2008 at 122-123 and October 22, 2008 at 206.

[7] Division Record Request No. 7.

[8] Transcript dated October 22, 2008 at 201.

Hospital would qualify) receive guaranteed year-round reliable uninterruptible gas service at approximately $0.65/dekatherm.[9] Based upon the record evidence in this proceeding, the Hospital submits that it is simply not just and reasonable to require extra large, high-load non-firm gas customers to pay 400% more for non-firm service than it would have paid for firm gas service.

The costs that underlie National Grid's firm rates are fully vetted in the context of a rate proceeding and the Commission will set rates for that service that are just and reasonable. No customer that receives lower quality non-firm service should be paying more than the applicable firm rate. Moreover, the Company's current non-firm service rate bears <u>no relationship</u> to either (1) the price that the Company charges firm ratepayers for gas usage or (2) the Company's costs of providing non-firm delivery services. Accordingly, the Hospital respectfully submits that the current rate utterly fails to meet the standards of R.I. Gen. Laws §39-2-1.

C. The Company's Proposal to Cap Its Non-Firm Rate at 150 percent Of a Yet-To-Be Determined "Firm Rate" Will Result in Unjust and Unreasonable Rates and Should Be Rejected by the Commission.

1. <u>National Grid Failed to Demonstrate Why Non-Firm Ratepayers Should Pay Rates Above those Charged Firm Ratepayers.</u>

The Company's rate proposal for non-firm ratepayers should be rejected by the Commission. First, the Company's proposal to cap its non-firm rate above the Commission's approved firm rate is unfair, unsupported by the evidence and unreasonable. National Grid provides monopoly gas service to Rhode Island. The Commission is charged with evaluating National Grid's known and measureable costs and then establishing rates to allow the recovery of those costs plus an allowed rate of return. In this proceeding, the Commission must establish a just and reasonable rate for firm gas service.

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9 Transcript dated October 8, 2008 at 138.

Despite its burden to do so, the Company has provided no rationale for the Commission to set non-firm rates to cap at 150 percent more than the just and reasonable firm rate.[10] In contrast, as demonstrated above, the nature of non-firm service is such that non-firm customers should pay substantially less and *not more* than firm ratepayers.

Accordingly, the Hospital respectfully requests that the Commission find that there is no record evidence to support establishing non-firm rates in excess of National Grid's just and reasonable firm rates.

2. <u>The Company Has Failed to Adhere to Well-Established Rate Design Principles to Establish Non-Firm Rates.</u>

The Company's mechanism to design rates for non-firm customers differs entirely from its proposed firm rate design. By failing to allocate costs based upon the costs imposed on a customer class, National Grid's proposed non-firm rates are unreasonable. Specifically, to design its proposed commercial and industrial firm rates, the Company adhered to long-established rate design metrics and set rate units for a variety of customer types including: (1) medium and large customers using a low number of volumes; (2) large customers with a low load factor; (3) large customers with a high load factor; (4) extra large customers with a low load factor; and (5) extra large customers with a high load factor. In contrast, the Company classified its non-firm customers according to minimal volumetric factors rather than "having to go through an exercise of assigning them to what their, 'corresponding firm rate' would be."[11] Thus, rather than specify the rate for non-firm C&I customers similar to established rate-design standards, the Company created rates by characterizing non-firm C&I customers based upon a single volumetric level (*i.e.*, 25,000 therms).[12] Specifically, those customers that use more than

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10 Transcript dated October 8, 2008 at 40-41.

11 Transcript dated October 8, 2008 at 135, also Exh. NGRID-3.

12 Transcript dated October 8, 2008 at 136-138.

25,000 therms annually would be capped at one rate for non-firm service. Conversely, those customers using less than 25,000 therms annually would be capped at a different rate.[13] National Grid has proposed to cap its non-firm volumetric-based rate at 150 percent above a yet-to-be determined rate.[14] Under this scenario, those customers using greater than 25,000 therms annually would have their non-firm rate capped at $1.70/dkth.[15] Those customers using less than 25,000 therms annually would experience a non-firm rate cap at $4.29/dkth.[16]

Simply stated, if the Commission determines that $.66/dkth is a just and reasonable rate for the Company's Extra Large High Load Factor firm customers, then it cannot be just and reasonable to permit the Company to charge non-firm customers up to $1.70/dkth for a more limited service.

D. Rhode Island Hospital's Proposed Non-Firm Rate Structure Includes a Fair and Equitable Contribution for the Cost of the Distribution System, Is Beneficial to Non-Firm and Firm Ratepayers and will Result in Just and Reasonable Rates.

The Company presented multiple Cost of Service studies (most recently on November 5, 2008) during the course of this proceeding in an effort to establish National Grid's cost to serve its non-firm customers.[17] As detailed herein, these studies are seriously flawed with respect to non-firm customers.

A cost of service study first classifies costs as customer related, demand related or commodity related. For example, metering, billing and administrative services are typically allocated as customer-related costs. Commodity-related costs are those that generally vary with

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13 *Id.*

14 Exh. NGRID-15

15 It should be noted that if the Company were to apply its 150% maximum rate to the firm rate for extra high load factor customers (the rate class for which Rhode Island Hospitals would qualify), the rate would be $.99 per dekatherm, not $1.70. *See* Transcript October 18, 2008 at 139.

16 Transcript dated October 8, 2008 at 135.

17 Exh. RIH-4 was initially offered by National Grid as its Cost of Service Study. Subsequently, on November 5, 2008, the Company submitted a revised Cost of Service Study.

throughput. Demand-related costs, at issue in this proceeding, are related to the capital investment need to meet firm customer peak demand.[18]

Next, the Company determines which of those costs are incurred to serve a specific customer class[19] and allocates the particular costs to the customer class. As detailed below, in allocating demand-related costs, the Company failed to acknowledge that demand-related costs are incurred to serve large firm C&I customers, not non-firm customers.[20] As a result of this apparent flaw, National Grid has fully allocated to non-firm customers those demand costs that were incurred to meet the needs of firm customers only and not usage by non-firm customers.[21] Consequently, even though National Grid has acknowledged that it does not invest in distribution capacity to serve non-firm customers, it allocated those very same costs to the non-firm class as if investments are made to serve both firm and non-firm customers equally. This allocation methodology directly contradicts Mr. Heintz's prefiled testimony wherein he states:

> The concept of cost causation is the fundamental and underlying philosophy applicable to all cost studies performed for the purpose of allocating costs to customer groups. Cost causation addresses the question: "Which customer or group of customers causes the utility to incur particular types of costs?"[22]

From purely a cost causation perspective, the Company's acknowledgment that it has incurred no distribution system demand costs to serve its non-firm ratepayers, means that none of those costs should be allocated to non-firm customers. Although it would be perfectly reasonable and appropriate to do so, the Hospital does not recommend that the Commission determine non-firm rates based solely on cost causation principles. Rather, the Hospital

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18 Exh. NGRID-15.

19 *Id.*

20 Rhode Island Hospital has no significant disagreement with the Company's allocation of customer and commodity related costs to the non-firm class.

21 Appropriately, some minor costs are not attributed to non-firm customers (*e.g.*, Customer Service & Information Expense and Sales Expenses: Accounts 907- 916).

22 Exh. NGRID-14 at 5, lines 5-8.

acknowledged that it is appropriate for non-firm customers to contribute a fair and reasonable amount to offset rates for firm customers lo long as this contribution fairly reflects lesser service received by customers.

Accordingly, National Grid's proposal to allocate the full amount of distribution system demand costs (*i.e.*, $2,145,049) to the non-firm customer class is simply unjust and unreasonable. Indeed, if we were to apply the very cost causation principles which the Company espouses, none of those costs would be allocated to non-firm rates. Nevertheless, the Hospital recommends that some allocation of demand costs to non-firm customers may be appropriate. We submit that the record supports an allocation of no more than 50% of those distribution demand costs to non-firm customers. Thus, at most, the total contribution of the non-firm class would be $1,072,525 (*i.e.*, 50 % of the fully allocated distribution demand costs) plus the fully allocated customer and commodity costs. Indeed, we think a lower number would be more equitable. That total, based upon the Company's most recent cost of service study would be $1.8 million. This number is more representative of the historic level of revenues collected from this class.

During the hearings, the Hospital's expert, Mr. DeMetro, proposed to set non-firm rates at an amount that would ensure National Grid could generate its historic level of revenues. Mr. DeMetro relied upon National Grid's Exhibits 36, 38 and 39[23]to conclude that a non-firm rate at 40% discount from firm rates would collect the target revenues. Based upon the November 5, 2008 cost of service study submitted by the Company, Mr. DeMetro concludes that the Company

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23 Exh. NGRID-36 is a schedule showing revenue impacts associated with various non-firm pricing options. This exhibit was updated and entered into the record by the Hospital as Exh. RIH-3. Exh. NGRID-38 is a summary of the Company's cost of service study, including non-firm customers. Exh. NGRID-39 is the Company's updated non-firm cost of service study.

will collect revenues of at least $1.8 million from non-firm customers if the non-firm rate is set at 35%-40% less than the rate set for firm customers.

Accordingly, the Hospital respectfully requests that the Commission direct National Grid to establish non-firm rates based on a discount of 35%-40% to the otherwise applicable firm rate such that total non-firm revenues of $1.8 million would be generated from non-firm ratepayers.[24]

During the hearings, the Company questioned whether non-firm rate customers should receive what was characterized as a "rate decrease" while other customers would experience an increase in rates. Such an argument, however, ignores the fact that the Hospital (and other non-firm customers) has paid National Grid significantly more than it would have as a firm ratepayer. The fact that firm customers have been paying rates below National Grid's cost and will likely see an increase in their rates is not a justification for continuing to charge non-firm customers as much as four times the level of firm rates. The Hospital's proposed non-firm rate structure is designed merely to ensure that non-firm customers pay a fair and reasonable share for its use of National Grid's gas distribution system infrastructure.

Similarly, National Grid has questioned whether non-firm ratepayers should receive a greater "rate decrease" than the Company's low-income ratepayers. Even assuming *arguendo* that there is a connection between the two groups of ratepayers, which the Hospital unequivocally denies, the Company's reasoning fails to note the substantial evidence that demonstrates the unreasonably high price that non-firm ratepayers have paid since 2005, especially during the time that the price of oil increased above the cost of gas exponentially.

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24 Volumes consumed during the most recent 12-month period are significantly greater than the volumes used to generate the Company's latest cost of service study. While Rhode Island Hospital does not object to the Company's recent volumetric estimate to determine the level of discount to firm rates that will generate $1.8 million in non-firm margins, the Hospital notes that actual volumes are likely to be more in line with current levels and, if so, National Grid will generate significantly greater revenues than the target amount of $1.8 million.

E. The Company's Proposal to Maintain Value of Service Pricing is Detrimental to Non-Firm Ratepayers.

Under a Value of Service ("VOS") scheme, the price for non-firm sales services changes monthly based upon the price that the customer would pay for its alternative fuel less a discount related to the volume of the customer's gas consumption.[25] The Commission noted that it implemented the VOS pricing mechanism to provide local gas distribution utilities the ability to more fully utilize the existing gas distribution system.[26] Since it could interrupt these customers at any time, it could serve them without the need to invest any additional capital in its distribution system. When firm customers were not utilizing their entitlements, utilities can serve this class and the revenues received from this class would help defray the cost of the system. The level of revenues collected from non-firm customers to defray these costs has historically been determined by discounting the customer's alternate fuel price since those prices, with few exceptions, have been significantly lower than firm service costs from the inception of the non-firm service.[27] Since 2004, however, prices for fuel alternatives, such as oil, have increased sharply as compared to prices for natural gas supply and have exceeded the cost of firm gas distribution service. Yet, under the Company's VOS pricing methodology, the Company continues to charge non-firm customers rates for natural gas delivery service that are based upon the customer's alternative fuel costs. As a result, distribution service rates for non-firm customers have increased and exceeded the rates for firm service, not because natural gas costs or the Company's costs have increased, but simply because oil prices have increased.[28] Accordingly, in its Order in Docket No. 3887, the Commission stated that, in the instant

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25 *See the Commission's Order dated October 11,2007 in* Docket No. 3887 at 1.

26 *Id.*

27 *Id.* at 2.

28 Transcript dated October 22, 2008 at 201.

proceeding, it would evaluate whether to set non-firm rates based upon a fixed contribution to the cost of the distribution system rather than VOS.[29]

During this proceeding, the Company has maintained that a VOS rate design policy is an appropriate methodology for determining rates for non-firm service customers. The Hospital disagrees and notes that such a pricing structure is unreasonable and is creating undue and unnecessary hardships on a number of the State's largest employers at a time of national economic uncertainty and when, according to the US Labor Statistics as of September 2008, Rhode Island has the highest unemployment rate in the United States.

It is no longer reasonable to maintain a rate structure that causes Rhode Island's non-profit and for-profit businesses to pay for natural gas service based upon a much higher priced alternative fuel. This methodology is producing costs significantly above those to serve non-firm customers and four times higher than the Commission-approved as just and reasonable rates for firm customers. Thus, the proposed rate structure results in unjust and unreasonable rates and will impose substantial harm on non-firm ratepayers. Accordingly, it should be rejected by the Commission.

Moreover, the Company's proposed VOS pricing mechanism for non-firm gas service makes it difficult for non-firm customers like the Hospital to budget energy costs because of the extreme volatility of gas prices. The combination of high prices and extreme volatility renders the current VOS method both unfair and unreasonable.

Accordingly, the Hospital respectfully requests that the Commission find that value of service pricing based on alternative fuel prices is no longer viable for the State's institutions and businesses that utilize National Grid's non-firm service rates and that continuation of VOS pricing would be inconsistent with the public interest.

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29 *Id.* at 4.

VI. CONCLUSION

As outlined above and demonstrated by the evidentiary record in this proceeding, the Hospital respectfully requests that the Commission:

(1) **FIND** that interruptible gas service is inherently different from firm gas service and, as such, should not be charged rates that are equal to or greater than those paid by firm customers;

(2) **FIND** that the Company's proposal to charge non-firm customers based upon an annual volumetric usage of 25,000 therms is unreasonable and not in the public interest;

(3) **FIND** that capping the non-firm rate at $1.70/dkth for those customers using 25,000 therms or more annually and $4.29/dkth for those customers using less than 25,000 therms annually will yield rates that are not just and reasonable;

(4) **FIND** that non-firm rates can be fairly and equitably established by allowing the Company to forecast estimated revenues equal to $1.8 million; and

(5) **ORDER** National Grid to file fixed rates for non-firm customers that are based on each customer's applicable firm rate and are at a level of discount of 35%-40% such that the class will generate an estimated $1.8 million of margin revenue to be credited to firm customers, utilizing the non-firm volumes contained in its latest cost of service study (*i.e.*, 3,106,300 dekatherms).

Respectfully submitted,

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